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NO. 85-568

IN THE

Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL, *et al.*,

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF FOR THE TOWN OF HIGHLANDS, NORTH CAROLINA, AS *AMICUS CURIAE* SUPPORTING MOTION TO DISMISS OR AFFIRM

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QUESTIONS PRESENTED

1. Is a state preempted from setting a utility's rates to retail customers by "rolling-in" all costs of two integrated utilities (including those costs incurred under FERC-filed rate schedules) and allocating those combined costs to the public on the basis of load, so as to require a utility and its sole stockholder, rather than the utility's ratepayers, to bear the costs of the stockholder's abuse and manipulation of its subsidiary for the stockholder's benefit, where FERC explicitly recognized that the state's determination regarding roll-in may differ from its own, and where FERC itself did not follow the FERC-filed rate schedules in setting that utility's rates to wholesale customers?

2. Is a state precluded by the Commerce Clause from setting retail rates in the above-described manner and placing refund responsibility on the utility and its stockholder, where the sole stockholder is an industrial corporation with a plant located in another state and chooses to attribute the refunds imposed on it to its costs of production in that other state?

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The Town of Highlands, North Carolina, purchases power from Nantahala Power and Light Company ("Nantahala") at wholesale. Highlands was an active participant in the roll-in proceedings at the Federal Energy Regulatory Commission ("FERC") which paralleled the North Carolina Utility Commission ("NCUC") proceedings here appealed.[1] Aluminum Company of America's ("Alcoa") Jurisdictional Statement

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[1]*Nantahala Power and Light Co.*, Opinion No. 139, 19 F.E.R.C. ¶61,152, *reh'g denied*, Opinion No. 139-A, 20 F.E.R.C. ¶61,430, Opinion No. 139-B, 21 F.E.R.C ¶61,222 (1982), *aff'd, Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984). Highlands also is a key participant in the ongoing litigation before the FERC concerning Appellants' subsequent efforts to contractually separate Nantahala and Tapoco, Inc. *Tapoco, Inc.*, 30 F.E.R.C. ¶63,050, *clarified*, 31 F.E.R.C. ¶63,056 (1985) (exceptions pending).

("J.S.") and the supporting briefs of Tennessee, the Edison Electric Institute ("EEI") and the Federal Amici, seriously mischaracterize the FERC decisions which are so critical to the issues they seek to raise in this Court. Highlands also has an interest in Nantahala's continued ability to serve, and thus a concern that Alcoa should bear any Nantahala retail refund responsibility, and filed an *amicus* brief below.[2]

INTRODUCTION AND COUNTERSTATEMENT OF THE CASE

Alcoa's Jurisdictional Statement and the supporting briefs labor hard to present this case as something it is not. This is not a case of conflict between retail electric regulation in Tennessee and North Carolina, or between the public loads of an electric system in two states. It is not a case in which North Carolina sought to benefit its electric consumers at the expense of electric consumers in other states. It *is* a case in which the NCUC has protected the retail public load of what it found to be an integrated Nantahala/Tapoco electric system, consisting of two North Carolina public utilities, from exploitation by the system's sole shareholder, Alcoa, itself a North Carolina public utility. That Alcoa has benefitted at the public's expense by transferring low-cost power to its aluminum smelter in Tennessee, by means of Tapoco, and that the public customers of the system are located in North Carolina, does not raise substantial Commerce Clause or preemption questions.[3]

[2] Letters from Appellants and Appellees providing consent to file this *amicus* brief have been filed with the Clerk of the Court. Highlands also is a political subdivision of a state within the meaning of Supreme Court Rule 36.4.

[3] Tennessee and EEI argue that the NCUC's roll-in order gives rise to substantial federal questions because the Tennessee regulatory commission might lower Tapoco's rates to Alcoa's Tennessee plant (Tenn. Br. 9; EEI Br. 12). They neglect to mention that Tapoco's rates to Alcoa are not, and have never been, regulated by the Tennessee Public Service Commission. That rate schedule is regulated by the FERC as a rate schedule of a hydroelectric licensee under Part I of the Federal Power Act (16 U.S.C. §§812 and 813; *see also* 18 C.F.R. §35.21 (1985)), and was not at issue in, or affected by, the FERC orders pertinent here (J.S. Appendix ("App.") 309a).

Tennessee also asserts that it "has had no opportunity to participate in the decisions at issue" (Tenn. Br. 4; *see also id.* at 10, 11). In fact, it

Nor is this a case in which the NCUC's regulation of three North Carolina public utilities conflicts with any order of the FERC. Contrary to the assertions of the Federal Amici, FERC Opinion No. 139 did *not* allocate costs between affiliated utilities or between states. The FERC addressed the New Fontana Agreement ("NFA") and the 1971 Apportionment Agreement only in the context of setting Nantahala's rates to three *wholesale* customers. That the FERC exercised discretion to reject rolled-in ratemaking for Nantahala's wholesale rates does not preempt the NCUC from using roll-in for Nantahala's *retail* rates; that the FERC found no abuse of the Federal Power Act does not preempt the NCUC from determining that the three affiliated public utilities have abused North Carolina law. The FERC cannot preempt the NCUC now through a misleading characterization of Opinion No. 139 in a brief; nor can Alcoa do so by choosing to attribute its refund liability to the cost of electricity at its Tennessee smelter.

Conspicuously absent from the briefs of Alcoa and its allies is any mention of the long history of Alcoa's manipulations to obtain low-cost hydroelectric power at the expense of the public, discussed by the North Carolina Supreme Court (J.S. App. 18a-32a). The Nantahala and Tapoco hydroelectric systems are the end result of more than 40 years of corporate organizations, acquisitions and name changes, and transfers of hydroelectric properties among Alcoa, its various subsidiaries and the Tennessee Valley Authority ("TVA"), maneuverings which allocated the least-cost generation to Alcoa's smelter through Tapoco (*id.* at 18a-20a, 23a-24a, 25a-26a). Moreover, Alcoa sought preferred access to even Nantahala's hydroelectric power by purchasing most of Nantahala's output at rates lower than Nantahala's costs *and* lower than its rates to other retail customers. The North Carolina courts ruled that this was unlawful discrimination. *Utilities Comm'n* v. *Mead Corp.*, 238 N.C. 451, 78 S.E.2d 290 (1953), discussed in the decision under review at J.S. App. 26a-28a. At the time it negotiated the NFA,

submitted an *amicus* brief in the appeal to the North Carolina Supreme Court, and its arguments were considered by that Court (J.S. App. 10a, 160a).

Alcoa sought to obtain all of Nantahala's major hydroelectric generation for its own use by selling the distribution system to Duke Power Company. The North Carolina Supreme Court halted the sale. *Utilities Comm'n* v. *Haywood Electric Corp.*, 260 N.C. 59, 131 S.E.2d 865 (1963), discussed in the decision under review at J.S. App. 28a-29a. In the 1960's, Nantahala's public load grew substantially, but Alcoa added no generation to the Nantahala system after the mid-1950's (*see* the discussion in the decision under review, J.S. App. 26a-27a). In 1971, Alcoa ceased purchasing directly from Nantahala, but indirectly appropriated part of Nantahala's generation, through Tapoco, in the 1971 Apportionment Agreement (*id*. at 30a-31a). Nantahala was left to obtain the growing amounts of supplemental power it needed to serve its public load from TVA, whose rates escalated dramatically during the 1970's (*id*. at 31a-32a). Throughout this history, Alcoa engaged in a largely successful effort to evade Federal regulation of its subsidiaries' hydroelectric projects and of the bulk power contracts with TVA, and with and among its subsidiaries, which maximized the usefulness of the Nantahala/Tapoco system resources for aluminum smelting (*id*. at 19a-20a, 21-22a, 29a, 30a, 31a).

In the orders at issue here, the NCUC looked through the structure created by Alcoa and found a single integrated Nantahala/Tapoco system, and domination of Nantahala by its shareholder for the shareholder's benefit and to the injury of Nantahala's ratepayers. To remedy this corporate abuse, the NCUC combined the two systems for ratemaking purposes, and allocated costs to the public using the allocation methodology commonly used for utilities that operate in more than one state. The NCUC then pierced the corporate veil between Nantahala and Alcoa to hold the parent responsible for the injury to the public caused by its actions. *See infra* at pages 9, 13 and 14-15.

In the parallel wholesale rate case, the FERC held that Nantahala's arrangements with its affiliates did not compel roll-in to set just and reasonable rates to Nantahala's three wholesale customers,[4] although it acknowledged the NCUC's earlier use of

[4] Opinion No. 139, J.S. App. 290a-295a; Opinion No. 139-A, J.S. App. 304a-308a.

roll-in to set Nantahala's retail rates.[5] The Court of Appeals affirmed the Federal Commission's roll-in determination as an exercise of ratemaking discretion. *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342, 1348 (4th Cir. 1984). The FERC did *not* approve or modify the NFA or the 1971 Apportionment Agreement to determine a just and reasonable allocation of costs between North Carolina and Tennessee or between Tapoco and Nantahala, contrary to the representations in the Jurisdictional Statement and supporting briefs. Opinion No. 139, J.S. App. 298a; Opinion No. 139-A, J.S. App. 309a, 311a.[6] In fact, the FERC stated explicitly that the decision did not affect Tapoco's entitlements under those rate schedules (Opinion No. 139-A, J.S. App. 309a). Rather, in determining the just and reasonable rates for Nantahala is wholesale customers, the FERC found that Nantahala inexplicably had surrendered the greater benefits of an earlier (unfiled) Nantahala-Alcoa apportionment contract without consideration, and that the 1971 Apportionment Agreement was unfair to Nantahala. It therefore set rates as if Nantahala had received more TVA energy than it was entitled to receive pursuant to the 1971 Agreement. Opinion No. 139, J.S. App. 295a-298a; Opinion No. 139-A, J.S. App. 309a, 311a.

I. THE NCUC'S ORDERS RAISE NO SUBSTANTIAL PREEMPTION QUESTION

A. FERC Opinion No. 139 Does Not Preempt The NCUC's Treatment of Federally-Filed Rate Schedules

What is most revealing about the preemption arguments of Alcoa and its allies is their inconsistency regarding what allocation of TVA entitlements they believe the NCUC was required to use in setting retail rates. At times, they seem to be saying

[5] *Compare* the suggestions in the Jurisdictional Statement (at 11, 20), EEI's brief (at 10), and the brief of the Federal Amici (at 4 n.6) that the NCUC rejected or "collaterally attacked" an earlier FERC determination (*but see* J.S. 9 n.11).

[6] Indeed, the 1971 Apportionment Agreement was not even filed with the FERC by Nantahala and Tapoco until 1980 — four years after

that the NCUC is required to use the FERC-filed rate — the 1971 Apportionment Agreement — in setting retail rates.[7] At other times, they criticize the NCUC for failing to follow the cost allocation utilized by the FERC in Opinion No. 139.[8] The problem is that the filed rate is *not* the same as the entitlements FERC imputed in setting rates to Nantahala's three wholesale customers.

This confusion in the briefs of Alcoa and its allies demonstrates that their preemption arguments proceed from a fundamental mischaracterization of Opinion No. 139. This is *not* a case where FERC "expressly approved different interstate allocations of the power and wholesale costs" (J.S. 18).[9] In Opinion No. 139, FERC left the "interstate allocations" — the filed rate — unchanged, but *departed* from those allocations in order to achieve just and reasonable rates to Nantahala's three wholesale customers. Rather than reviewing the interutility transactions in its role as regulator of bulk power transactions, FERC in Opinion No. 139 viewed them in its role as regulator of Nantahala's rates to its three wholesale customers, a role parallel to the NCUC's role in setting Nantahala's rates to retail customers.[10] In its Order Denying Rehearing, FERC emphasized that in Opinion No. 139 it acted only in the context of establishing just and reasonable rates for wholesale customers and was not purporting to allocate interstate power flows or costs:

Nantahala filed its wholesale rate increase — and even then it was filed only under protest (*see* the North Carolina Supreme Court's discussion at J.S. App. 31a).

[7] *See, e.g.,* J.S. 16-17; Fed. Br. 8; EEI Br. 11.

[8] *See, e.g.,* J.S. 17-18; Fed. Br. 6; EEI 8, 15; Tenn. Br. 5-6.

[9] *See also* the erroneous proclamation of the Federal Amici (Br. 6) that "The Federal Energy Regulating [sic] Commission has made determinations pursuant to its unquestioned authority over wholesale transactions concerning how 'entitlements' to certain power, received in return for other power, should be divided between two utilities, serving neighboring states."

[10] *Compare* Alcoa's assertion that the NCUC and the FERC disagreed over whether the NFA and 1971 Apportionment Agreement and Nantahala's TVA purchases benefitted retail ratepayers (J.S. 19).

> Docket No. ER76-828 originated with a proposed rate increase by Nantahala under its Rate Schedule PL, which governs charges to customers using electric service for resale. That proposed rate increase was set for hearing under both Sections 205 and 206 of the Federal Power Act [16 U.S.C. § § 824d and 824e], thus giving the Commission authority to order refunds should it find Nantahala's rates were not just and reasonable. In Opinion No. 139 the Commission found the proposed charges were not just and reasonable. Among the reasons for our finding was that the 1971 Apportionment Agreement . . . does not afford Nantahala its fair share of NFA energy entitlements, and the rates under Rate Schedule PL are directly affected by the amount of entitlements received by Nantahala. The Commission specifically stated that it was not reforming the 1971 Apportionment Agreement. Instead, the Opinion sets rates for Nantahala as though it had received its fair share of entitlements. The Commission properly acted under Section 205 of the Federal Power Act in setting just and reasonable rates.

Opinion No. 139-A, J.S. App. 310a-311a. The FERC then added: "[W]e have not modified Nantahala's contracts [under Section 206]. Instead, we have set just and reasonable rates under our powers under Section 205" (*id.* at 312a).[11] FERC's actions therefore are of a completely different nature than the exercise of Federal authority to divide power between two states. Under these circumstances, there is no substantial preemption question.

The argument that preemption and the filed rate doctrine preclude the NCUC from protecting retail ratepayers pursuant to North Carolina law by allocating costs to the public on a basis other than the literal terms of the 1971 Apportionment Agreement is untenable. Alcoa and its allies in effect claim that while the FERC in setting rates to wholesale ratepayers can

[11] *Compare* J.S. 18, where Alcoa characterizes Opinion No. 139 as acting under Section 206 of the Act, "approv[ing] different interstate [power] allocations . . . " *See also* J.S. 7-8.

decline to follow the filed rate so as to make wholesale rates just and reasonable under the Federal Power Act, North Carolina cannot treat the same agreements in the same manner to achieve what it concluded are just and reasonable retail rates. The FERC did *nothing* to protect Nantahala's retail customers. This argument would leave them completely unprotected from what both Federal and North Carolina authorities found to be unreasonable costs. The preemption doctrine does not compel such oppression. In setting rates to wholesale customers, FERC is as bound by the filed rate doctrine as is a state commission.[12] Because that doctrine did not prevent FERC from setting wholesale rates on another basis, it does not require the NCUC to pass through to Nantahala's retail ratepayers the full cost of the 1971 Apportionment Agreement.

Nor is there any basis for concluding that the FERC intended to require the NCUC to use for retail ratemaking purposes the same assumed entitlements that it used for wholesale rates. There is no question that states in setting rates to retail customers and the FERC in setting rates to wholesale customers may use different ratemaking methodologies. *Public Systems* v. *FERC*, 709 F.2d 73, 84 (D.C. Cir. 1983). Opinion No. 139 amply illustrates the wide yet accepted divergence between the ratemaking policies of these two jurisdictions.[13]

Nor can it be seriously asserted that the Federal Power Act preempts states from applying their own laws and policies regarding abuse by public utilities. In determining whether roll-in was appropriate for setting Nantahala's wholesale rates, FERC expressed "[t]he central question . . . [as] whether . . . Alcoa has used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act" (Opinion No. 139, J.S. App. 290a) — whether an industrial

[12] *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 578 (1981); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956).

[13] The FERC rejected an NCUC-accepted treatment of amortization of Nantahala's major generating facilities (19 F.E.R.C. at pp. 61,286-87; 20 F.E.R.C. at pp. 61,872-74), and an NCUC-accepted purchased power adjustment clause. Their methods for determining rate base and rate of return differ significantly. *Compare* 19 F.E.R.C. at pp. 61,285-86 *with* the NCUC order, J.S. App. 222a-226a.

company not itself a "public utility" under Part II of the Federal Power Act[14] had used jurisdictional subsidiaries to frustrate the Act. In contrast, the NCUC was applying North Carolina law regarding abuse and domination by Alcoa, a North Carolina public utility, of its integrated North Carolina public utility subsidiaries.[15] Thus, in the words of the North Carolina Supreme Court (J.S. App. 90a), the NCUC

> determined that it was inappropriate to allow Nantahala to collect all of its revenue requirements from its public customers on the theory that it was a stand-alone company, because Nantahala's "stand-alone" costs under the corporate and contractual arrangements were not incurred for their benefit, but as a result of Alcoa's corporate dominance for Alcoa's benefit.

Indeed, in Opinion No. 139-A, the FERC expressly acknowledged that although it declined to use roll-in for wholesale ratemaking pursuant to the Federal Power Act, North Carolina applying State criteria could validly require roll-in (J.S. App. 305a):

> We recognize that the North Carolina Utilities Commission (NCUC), based on a similar record, reached a different conclusion concerning rolled-in costing. However, the question of whether to treat various entities as an integrated system for ratemaking purposes is not a purely factual question, but also rests on criteria which each ratemaking authority may deem relevant.

To require the NCUC to adhere to the precise entitlements that the FERC imputed to Nantahala would be to single out and remove from its context one of the package of adjustments

[14] *Alcoa Generating Corporation*, 5 F.E.R.C. ¶61,133 at p. 61,323 (1978). Highlands has consistently maintained that Alcoa should be found jurisdictional under Part II of the Federal Power Act.

[15] The FERC stated that it gave no weight to Tapoco's status as a public utility under North Carolina law (Opinion No. 139, J.S. App. 293a & n.21).

ordered by FERC to achieve what it found to be just and reasonable wholesale rates under the Federal Power Act. For example, because Nantahala failed to follow FERC regulations regarding automatic adjustment clauses, the FERC disallowed Nantahala's purchased power adjustment clause ("PPAC").[16] This operated to disallow from wholesale rates certain costs of Nantahala's TVA purchases in addition to the TVA power costs disallowed by the imputation to Nantahala for ratemaking purposes of energy entitlements greater than those contained in the 1971 Apportionment Agreement. Would the NCUC also be required to reject Nantahala's retail PPAC, which was otherwise acceptable under North Carolina standards? The wholesale ratemaking package chosen by FERC for 7% of Nantahala's sales could well require refunds exceeding Nantahala's net worth if applied on a total-company basis without provision for reimbursement by Alcoa. The preemption doctrine requires no such result. The FERC's imputed entitlements no more bind the NCUC than the FERC's choice of rate of return.

Thus, Opinion No. 139 did not bind the NCUC either to rigid application of the filed rate that the FERC itself found unfair, or to application of the imputed entitlements approach that the FERC adopted (together with other adjustments) to achieve what it found to be just and reasonable wholesale rates. The FERC explicitly left it open to the NCUC to adopt roll-in to protect retail ratepayers.

B. The NCUC and North Carolina Supreme Court Decisions Are Entirely Consistent with the *Narragansett* Doctrine

The arguments that the North Carolina decisions are inconsistent with the *Narragansett* doctrine,[17] and the attempts to cast those decisions as episodes in a doctrinal controversy that requires resolution by this Court, are based on the premise that

[16] 19 F.E.R.C. at pp. 61,283-85; 20 F.E.R.C. at pp. 61,871-72; Opinion No. 139-B, 21 F.E.R.C. ¶61,222 at p. 61,500 (1982). These pages were not included in the Appendix to the Jurisdictional Statement.

[17] *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978). A number of cases in the

North Carolina defied an FERC allocation of costs between Nantahala's ratepayers in North Carolina and Tapoco's ratepayer (Alcoa) in Tennessee. As discussed above, this is *not* what the FERC did in Opinion No. 139. Thus, EEI's argument (Br. 8-12) that a state commission cannot use roll-in and traditional allocation methodologies if the resulting retail rates do not reflect all costs allocated to each utility through FERC review of an inter-utility power contract, even if valid, is irrelevant here. Because this case does not at all fit the mold of cases where state commissions interfered with or defied FERC interstate power costs allocations, it is an entirely inappropriate vehicle for the review of whatever controversies may be developing in those areas.

This case falls squarely within the line of state *and FERC* cases which recognize that the FERC may leave to the states determination of the prudence of power costs incurred by a utility under a wholesale contract, or the need for those costs to be incurred to serve retail ratepayers, and that state commissions and the FERC may reach different conclusions with regard to a utility's rates to its retail and wholesale customers.

In *Appeal of Sinclair Machine Products, Inc.*, No. 84-380 (N.H. July 26, 1985) (available on LEXIS, States library, NH file), the New Hampshire Supreme Court reversed the state commission for accepting in a retail rate case a utility's wholesale power purchases from its parent without scrutiny. The court held that although the state commission could not inquire into the reasonableness of the FERC-determined wholesale rate, "the PUC may always inquire into the reasonableness of a utility's purchasing power under a FERC-approved rate given other purchase options available to the utility." *Id.*, slip op. at 2. The court relied on FERC cases which neither Alcoa nor its allies mention. These cases hold that the FERC's determination that a bulk power transaction is just and reasonable does not prejudge a later prudence determination by either the state commission in considering whether the costs associated with such

Narragansett line are cited at pages 4, 14, and 18-19 of the Jurisdictional Statement, pages 10-11, and 13-14 of the EEI brief, page 7 of the Federal Amici brief, and page 9 of the Tennessee brief.

transaction should be passed through to utility's retail customers, or the FERC in separately considering whether these costs should be passed through to a utility's sale for resale customers. *Id.*, slip op. at 8-9, quoting *Philadelphia Electric Co.*, 15 F.E.R.C. ¶ 61,264 at p. 61,601 (1981), and *Pennsylvania Power & Light Co.*, 23 F.E.R.C. ¶ 61,006 at p. 61,009 (1983).[18] The New Hampshire court expressed the preemption doctrine as requiring

> examin[ation of] those matters *actually determined*, whether expressly or impliedly, by the FERC. As to those matters not resolved by the FERC, State regulation is *not preempted provided that* State regulation would not contradict or undermine FERC determinations and federal interests, or impose inconsistent obligations on the utility companies involved.

Id., slip op. at 9 (emphasis in original). The court then closely scrutinized the pertinent FERC orders, concluding that they did not preempt the state commission from determining the "reasonableness or prudency" of the utility's purchases. *Id.*, slip op. at 11.[19]

[18] *Accord, AEP Generating Co.*, 29 F.E.R.C. ¶61,246 at p. 61,501 (1984); *Southern Company Services, Inc.*, 26 F.E.R.C. ¶61,360 at p. 61,795 (1984); *Southern Company Services, Inc.*, 20 F.E.R.C. ¶61,332 at p. 61,694 (1982).

In *American Electric Power Service Corp.*, 32 F.E.R.C. ¶61,363 (1985) (rehearing pending), the FERC held that its determination of the justness and reasonableness of a transmission agreement that was integral to the operations of a multistate holding company power pool, subject to FERC and Securities and Exchange Commission jurisdiction, *would* preempt the states from considering the prudence of the transmission agreement. The FERC found that, in those circumstances, resolution of the transmission agreement controversies would leave nothing for the states to decide. 32 F.E.R.C. at pp. 61,817-19. Therefore, *American Electric Power Service* is completely unlike Opinion No. 139.

[19] *Accord, Pike County Light and Power Co.* v. *Pennsylvania Public Service Comm'n*, 77 Pa. Commw. 268, 465 A.2d 735 (Pa. Commw. Ct 1983). Although Alcoa characterizes this case as an exception to the general preemption rule (J.S. 20 n.28), *Pike County* is squarely within a well-established line of cases that are entirely consistent with those cases where state commissions have been reversed for overriding actual or potential FERC determinations of reasonableness.

Opinion No. 139 illustrates the principle underlying *Sinclair* and the FERC cases on which it relies. The FERC did not modify the 1971 Apportionment Agreement, but disallowed certain costs associated with that contract as not prudently incurred by Nantahala (Opinion No. 139-A, J.S. App. 312a). The NCUC determined that Nantahala was not even capable of prudent action on behalf of its ratepayers. It found Nantahala not to be an independent utility under North Carolina law, because it was developed as part of a single system by Alcoa and completely subjected to Alcoa's domination (*see* the NCUC's roll-in order at J.S. App. 233a). EEI's argument that the cases leaving questions of prudence and need for power to the states are not applicable to the NCUC's decision "because the prudence of Nantahala's power supply arrangements is not questioned" (EEI Br. 13 n.9) is utterly meritless.

EEI's radical attempt to curtail the jurisdiction of states to protect their citizens from corporate abuse resulting in excessive retail rates, by arguing that the NCUC was preempted from piercing the corporate veil, has absolutely no support in the case law. The NCUC did not use roll-in to defeat or disallow any FERC allocation of costs to North Carolina or Nantahala; the FERC did not approve or modify the NFA and 1971 Apportionment Agreement so as to fix Nantahala's just and reasonable purchased power costs for retail purposes. Thus, the cases on which EEI relies (Br. 12-14) are inapplicable here.[20]

See also Public Service Co. of Colorado v. *Public Utilities Comm'n of Colorado*, 644 P.2d 933 (Colo. 1982), where the Colorado Supreme Court held that the Colorado commission was not preempted from inquiring into whether a natural gas pipeline's R&D costs, incurred under FERC-approved wholesale rate schedules, were incurred for the benefit of retail ratepayers, or instead to benefit shareholders.

The extent of EEI's misunderstanding of the North Carolina decisions it asks this Court to review is revealed by its argument that the Colorado case is inapplicable because it concerned R&D expenditures and not power generation costs, which were involved in cases such as *Northern States Power Co.* v. *Minnesota Public Utilities Comm'n*, 344 N.W.2d 374 (Minn.), *cert. denied*, 104 S. Ct. 3546 (1984), and *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981) (EEI Br. 9-11, 10 n.7). The point is not the *types* of costs involved, but *why* and how they were approved or disapproved at the Federal and state levels.

[20] In *Sinclair Machine Products, supra*, slip op. at 12, the New

II. THE NCUC'S ORDERS RAISE NO SUBSTANTIAL QUESTION UNDER THE COMMERCE CLAUSE

Alcoa characterizes the NCUC's order as an attempt to give

> North Carolina customers a disproportionate and ever-increasing preference to the economic benefits of inexpensive hydroelectric power...[,] requir[ing] Tapoco's Tennessee customer to pay "refunds" equivalent to the higher cost of power it has allocated to Tennessee ..., thereby explicitly transfer[ing] economic benefits from Alcoa's plant in Tennessee to Nantahala's North Carolina customers and inhibit[ing] the exportation of hydroelectric power generated in North Carolina to Tennessee.

J.S. 21. This completely misconstrues the nature of the NCUC's orders and, in particular, the NCUC's explicit determination to hold Alcoa, *as Nantahala's dominating stockholder*, not as Tapoco's customer, responsible for manipulating its public utility subsidiaries to the detriment of the North Carolina public. Alcoa's attempt to insulate its abuses of North Carolina law from regulatory scrutiny by hiding behind the Commerce Clause should be rejected.

The NCUC's retail rate order neither intended nor resulted in economic protectionism or regulation of interstate commerce. The NCUC's establishment of retail rates by combining the

Hampshire Supreme Court held that the state commission could not use a piercing of the corporate veil rationale to disallow flowthrough of abandoned nuclear plant costs that the FERC had determined should be flowed from one utility to its retail subsidiary. In *Office of Public Counsellor* v. *Indiana and Michigan Electric Co.*, 416 N.E.2d 161, 164-65 (Ind. App. 1981), an Indiana intermediate appellate court held that where the FERC regulated sales to a utility by its nuclear generation subsidiary, a state commission could not use roll-in to reduce the FERC-determined rate of return received by the subsidiary for those sales. More generally, several cases hold that a state cannot disregard or disallow costs incurred by a utility under FERC-jurisdictional rate schedules *merely* on the grounds that the wholesale transactions involve affiliated companies. *See, e.g., United Gas Corp.* v. *Mississippi Public Service Comm'n*, 127 So.2d 404, 420 (Miss. 1961) (discussed at EEI Br. 13 n.10).

costs of Nantahala and Tapoco, and allocating to the public its proportionate share of the joint costs — as it does for every other utility operating in more than one state (*see* the North Carolina Supreme Court's discussion, J.S. App. 16a, 101a) — rested on factual findings well within the traditional purview of a retail commission. Roll-in was based on findings, as affirmed and summarized by the North Carolina Supreme Court, that Tapoco and Nantahala are North Carolina public utilities and that

> (a) Nantahala has not been designed, developed and operated as a stand-alone electric system, (b) the Nantahala and Tapoco electric facilities constitute a single integrated electric system, and (c) the two corporate affiliates should be treated as a single utility system for rate making purposes, in view of their historical development, actual operating conditions and the fact that Nantahala's customer cost responsibility cannot be accurately determined using a "stand-alone" model....

J.S. App. 136a-137a. The NCUC found that Alcoa dominated Nantahala, so that Nantahala was incapable of protecting its ratepayers, and therefore pierced the corporate veil and held Alcoa, as Nantahala's stockholder, responsible for the refunds which exceeded Nantahala's ability to pay (J.S. App. 233a).

It has long been recognized that when the interests of a regulated company are subordinated to an affiliate so as to benefit private interests to the injury of the public the regulatory scheme was designed to protect, it may be appropriate or necessary to pierce the corporate veil to halt and redress the injury.[21] Here, the NCUC has acted appropriately under North Carolina law to protect the interests of retail ratepayers because Alcoa has not behaved as a mere investor of Nantahala, but

[21] *See, e.g., Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 606-08 (1945); *United Fuel Gas Co.* v. *Railroad Comm'n of Kentucky*, 278 U.S. 300, 320-21 (1929); *Chicago, Milwaukee & St. Paul Ry.* v. *Minneapolis Civic & Commerce Ass'n*, 247 U.S. 490, 500-01 (1918); *see also Western Distributing Co.* v. *Public Service Comm'n of Kansas*, 285 U.S. 119, 124-25 (1932). *And see* the North Carolina Supreme Court's discussion, J.S. App. 113a.

rather, manipulated Nantahala and Tapoco to procure for itself low-cost power.[22]

State commissions plainly may act, without offending the Commerce Clause, to protect ratepayers from imprudent actions of public utilities, utility acquisitions that are not used and useful for retail ratepayers, or unreasonable costs imposed by inter-affiliate manipulations. Any disallowance of costs will have an impact on the company and its stockholders. The geographical location of the stockholders and their other interests does not create a Constitutional bar against a state commission's protection of retail ratepayers in this manner.

Moreover, the NCUC's orders have only an incidental effect on interstate commerce. The NCUC's orders are directed against Nantahala in the first instance. They are an unexceptional example of a state disallowing costs not incurred for the benefit of ratepayers. The NCUC went on to pierce the corporate veil, to require Alcoa to pay refunds exceeding Nantahala's ability to pay, but it expressly stated that this neither required nor contemplated any effect on Tapoco's rates to Alcoa (J.S. App. 241a, 243a). That Alcoa is both Nantahala's stockholder and Tapoco's customer, and that Alcoa's purpose in manipulating its subsidiaries has been to obtain benefits through Tapoco's sales to Alcoa's smelter, does not make refunds a cost of purchasing Tapoco power. Alcoa's choice of internal accounting methods certainly does not implicate the Commerce Clause.

Thus, the NCUC's orders do not impermissibly interfere with interstate commerce under the standards set forth in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970). Where a state "regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." 397 U.S. at 142 (citation omitted). The incidental burden on interstate commerce here cannot outweigh North Carolina's strong interest in effective utility regulation. *See, e.g.*,

[22] *See* the North Carolina Supreme Court's discussion, J.S. App. 113a-122a. *See also United States* v. *Reading Co.*, 253 U.S. 26, 48, 60-63

Arkansas Electric Cooperative Corp. v. *Arkansas Public Service Comm'n*, 461 U.S. 375, 377, 394-95 (1983).[23]

The NCUC's actions are not at all comparable to the economic protectionism held unconstitutional in *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982) ("NEPCO"). The NCUC did not prohibit the export of North Carolina hydroelectric power, or the economic benefits of such power, so as to retain that power for in-state residents. It only established Nantahala's retail rates in a manner which assures Nantahala ratepayers a fair allocation of the Nantahala/Tapoco resources, and does not disproportionately burden them with the costs of Alcoa's manipulations. No wholesale sales were ordered, and no changes in wholesale rates were the necessary consequence of the NCUC's orders. Moreover, in *NEPCO*, the state action forced the utility to incur a loss if it continued to sell hydroelectric power out-of-state; this loss served no legitimate (non-protectionist) state interest. There *is* an important state interest in requiring Alcoa, Nantahala's stockholder, to bear the costs incurred for its benefit and not for the benefit of the public load.

In *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, No. 84-2409 (8th Cir. August 23, 1985) (printed at J.S. App. 320a-344a), the Arkansas Commission explicitly sought to defy FERC orders requiring Arkansas Power & Light Company to share with its affiliates in other states the costs of a nuclear project. The NCUC's effort to protect public rate-

(1920); *Chicago, Milwaukee & St. Paul Ry.* v. *Minneapolis Civic & Commerce Ass'n, supra*, 247 U.S. at 500-01. Indeed, the North Carolina Supreme Court held that the statute that makes Alcoa a North Carolina public utility insofar as its ownership and control of Nantahala affects the latter's rates is designed to facilitate review and remedy of such abuses as were found in this case (J.S. App. 44a-54a, 110a-112a).

[23] Federal Amici appear to agree that if the NCUC's orders are not protectionist (which they are not), they would pass muster under *Bruce Church* (Fed. Br. 11). Their apparent suggestion that this Court use this case to reconsider well-established Commerce Clause tests in favor of what appears to be no test at all (Fed. Br. 12-13) is entirely inappropriate. The alleged "competing state interests" (Fed. Br. 12) boil down to Alcoa's efforts to escape the costs of its self-dealing.

payers from what it found to be the detrimental effects of Alcoa's dominance thus is not comparable to the Arkansas Commission's efforts to keep high-cost power out of Arkansas.

Alcoa and its allies place great emphasis on the NCUC's "first call" language in their effort to portray the NCUC's actions as economic protectionism. As explained by the North Carolina Supreme Court (J.S. App. 101a-103a), this language is neither the basis for nor the effect of the NCUC's orders.

Alcoa points to the NCUC's refusal to roll-in Alcoa's separate TVA purchases (J.S. 10). However, even Alcoa characterizes these purchases as among the sources of power for "Tapoco/ Alcoa and Nantahala" (J.S. 10 n.13), not for the integrated Tapoco/Nantahala system the NCUC was addressing. As found by the NCUC, TVA's direct sales to Alcoa are not part of Tapoco's utility operations, and even if they were, the cost of such specialized purchases would be separately assigned to Alcoa under standard allocation methodology (*see* the North Carolina Supreme Court at J.S. App. 65a-66a, and the NCUC at 211a-215a). The NCUC's finding against Alcoa on this question of fact and ratemaking policy does not raise any federal question.

Alcoa next complains that the NCUC's allocation of the Nantahala/Tapoco costs on the basis of Nantahala's "ever-increasing" demand for power somehow constitutes a "first call" on hydroelectric power (J.S. 10). There is nothing extraordinary about allocating system costs on the basis of load (*supra* at 14-15). That Nantahala's load is increasing as compared with Alcoa's partial requirements purchases from Tapoco simply means that Nantahala's ratepayers gradually will bear a greater proportion of the costs of all Tapoco/Nantahala resources (which will gradually include more TVA purchases). The NCUC's refusal to allocate costs on the basis of "Nantahala's contribution," as determined by Alcoa through its manipulation of the hydroelectric properties of its subsidiaries and through the contracts the NCUC has found detrimental to Nantahala's interests, does not evince economic protectionism but rather protection of ratepayers from abuse by the utility's industrial parent.

Contrary to Alcoa's claims (J.S. 10-11), the NCUC's use of the Nantahala/Tapoco system capacity rather than the NFA entitlements as the basis for its allocations does not provide North Carolina with "first call" on hydroelectric power. The NCUC found that in the NFA, Alcoa traded away the much larger system capacity of Nantahala and Tapoco to obtain entitlements peculiarly suited to its needs and of no value to the public (*see* the North Carolina Supreme Court's discussion at J.S. App. 67a-68a, 102a-103a). The NCUC's determination not to charge ratepayers for Alcoa's trade that achieved entitlements neither used nor useful to serve Nantahala's load does not constitute economic protectionism.[24]

Thus the NCUC's orders serve legitimate and substantial local interests with only incidental and not excessive effects on interstate commerce. They therefore raise no substantial question under the Commerce Clause.

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[24] Nor is Alcoa's argument advanced by the North Carolina Supreme Court's remand instructions that the NCUC consider whether Nantahala's customers would benefit from roll-in. *North Carolina ex rel. Utilities Commission* v. *Edmisten*, 299 N.C. 432, 442-43, 263 S.E.2d 583, 591 (1980). Requiring utility commissions to set rates to consumers at the lowest reasonable rate is neither extraordinary (*e.g., Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378, 388 (1959)) nor an impermissible intrusion on interstate commerce.

CONCLUSION

Alcoa's appeal should be dismissed or the NCUC orders should be summarily affirmed.

Respectfully submitted,

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